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Mechanics and Metals National Bank
Title:
Acceptances, their purpose and advantages
Place:
New York
Date:
[1917]

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Acceptances

Their Purpose and Advantages

~~THE FOREIGN TRADE CLUB~~

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Capital, Surplus and Profits, $18,000,000

Business

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Acceptances

HISTORICAL

MANY radical changes in the mechanism of national and international finance have taken place in the past few years.

Not the least important of these changes has been the creation of the American Bank Acceptance, the recognition of the Trade Acceptance, and the establishment of the American Discount Market.

Before speaking of the American Bank Acceptance and analysing it in detail, it might be of interest to touch briefly upon the subject of Bank Acceptances in general, and the experience gained by other nations while the use of the Acceptance was in the process of evolution.

The Acceptance is the simple and logical product of generations of trade and banking experience. Based upon the scientific systems of the leading European countries, it

long ago proved ample to meet all the requirements of commerce and trade. Indeed, it constituted a long step in the upbuilding of commercial banking in Europe. In every sense a commercial document, the Acceptance established a system under which commercial credit assumed a position of pre-eminence as a controlling attraction for liquid capital, a position in the money market to which that form of credit was rightly entitled.

The first people to lend their credit to others through the medium of the Acceptance were the English. The names of the London Acceptance houses of today, called "Merchant Bankers," are known throughout the world. Certain of these Acceptance houses were originally import merchants of exceptionally high standing, who paid for their imports by "accepting" long drafts drawn upon themselves by the shippers in foreign countries. After these drafts were accepted they were discounted with the Deposit Banks or private bankers at rates which had a distinct relation to the standing of the acceptors.

It is thus that the development of Acceptances came about. Merchants of a moderate standing who endeavored to follow the procedure of the larger houses encountered obstacles in the early stages, which made the financing of their importations a hardship. They either could not buy against their own Acceptances at all, or, if they could, the rates charged for discount and commission to insure the risk were so high that the final cost of the imported wares left too small a profit to compensate them for their labor.

These merchants soon found that by borrowing the signature of one of the leading merchants, they could finance their imports more advantageously. They found that the advantages gained far exceeded the small commission paid for the service. At the same time the leading merchants were quick to see the profit for themselves, and for the trade of the country, in lending their signatures by way of accepting drafts for other merchants.

On account of their intimate knowledge

of trade conditions, their knowledge of the various kinds of merchandise which were to be imported and which were pledged as security, of values, seasonal demands and markets, the leading merchants were particularly qualified to grant such credits. In the course of time, these merchants turned more and more to the business of lending their credit in the form of Acceptances, not only at home, but to foreign merchants, banks and corporations. In connection with this work, and on account of their intimate knowledge of certain overseas countries, they became pioneers in extending loans abroad, and thus exerted a vast influence on the expansion of English foreign trade.

While thus England was extending its credit all over the world, continental countries, particularly France and Germany, showed an economic growth which resulted in an ever-increasing demand for Acceptance credits whereby to finance their overseas trade. Having already developed a home market for their domestic Bank and Trade Acceptances, an effort was made

by France and Germany to break away from London and establish Franc and Mark Acceptances in the international exchange market.

The first efforts failed. One main reason for the failure, and for the preference given to the Pound Sterling, was found in the fact that London was the only free gold market in the world, a bill on London meaning gold and nothing but gold if demanded. Another reason was the superiority of the London discount market, which, guided by a farsighted discount policy on the part of the Bank of England, was always able and willing to absorb any bills offered in the market.

In final recognition of this undeniable preference for the Pound Sterling, a number of the most powerful continental banks established branches in London, and the new capital brought into that market was used by these foreign branch banks chiefly as a basis to grant Sterling Acceptance Credits, particularly, of course, for the benefit of customers of the home country. These credits have run into enormous figures.

Gradually French and German bankers were able to establish a limited market for Franc and Mark Acceptances, but as time went on these came to be used chiefly to finance their own imports.

Some of the factors found particularly effective in establishing Acceptance markets in foreign countries, which should be of special interest to America in its present endeavor to establish foreign markets for Dollar Acceptances, may be summarized as follows:

Large exports with which to offset imports.

Direct steamship connections with all important oversea ports.

Establishment of a charter market.

The upbuilding of insurance companies to underwrite marine and other risks.

Direct cable lines to foreign countries.

Extension of loans to foreign governments, thus encouraging valuable trade relations.

A strengthening of the financial structure at home and the establishment of a stable yet elastic discount market.

THE AMERICAN BANK ACCEPTANCE

Until the establishment of the Federal Reserve System, in 1914, America was one of Europe's best customers in the use of its Acceptance facilities. A large part of America's great import trade was financed via London, Paris and Berlin, through Bank Acceptances.

The annual tribute paid to Europe for this service was not only an unnecessary burden, but also reflected upon the dignity of a nation of the political and economic importance of the United States of America. The Federal Reserve Act finally gave to national banks the power to "accept".

The first long drafts drawn in dollars on American banks, when offered in the foreign markets, were looked upon by the foreign bankers with doubtful eyes, and could only be sold by the drawers at a disparity, as compared with the Pound Sterling.

Before long, however, banks and bankers all over the world began to realize that

America had set its new financial machinery in motion; that a discount market was rapidly being established; and that bank bills drawn on New York could readily be discounted and at advantageous rates.

As a consequence, foreign bankers began to quote closer rates for such bills—especially since, simultaneously with these offerings of American Bank Acceptances, a strong demand for remittances on New York and other American centers sprang up.

The reasons for this demand were obvious. America, as a result of the war, suddenly became the world's work-shop; its export trade increased to unparalleled figures. Aside from its trade with Europe, new markets were developed in Central and South America, the Far East, Africa, and Asia.

Formerly the foreign customer would have remitted to the American shipper a bill on London, Paris, or Berlin in settlement of his debt, leaving the risk of exchange to the American merchant, for to have remitted a draft on New York would have been too costly, there being

no market for such bills and foreign bankers therefore charging arbitrary rates and extra commissions for such service.

But with the new conditions bankers in foreign countries became ready buyers of American Bank Acceptances, wherewith to create New York funds, selling such funds in turn to their customers who had a debt to meet in the United States. Thus a channel was opened for the ebb and flow of credit transfers between the United States and all other countries, with the result that today the American dollar is quoted at all the principal exchange markets of the world.

DOLLAR ACCEPTANCES AGAINST IMPORTS

The Dollar Acceptance has taken a leading position in the world's credit markets, and has established itself firmly in the estimation of the American importer and exporter. Taking the importer first; what are the advantages of the Dollar Acceptance to the American importer?

FIRST: Cutting out of lost motion, and release from the commission formerly paid the London banker. If the American importer desires a sterling credit he must in most cases open it through the medium of an American bank. The commission which he pays must be sufficient to compensate the American bank as well as the London bank on which the credit is drawn. In other words, for a sterling credit the importer pays two commissions, while for a dollar credit he pays but one.

SECOND: Elimination of the risk in exchange. By the use of the Dollar Acceptances the American importer knows exactly what his goods cost him, and there is no ambiguity as to how much money he owes his bank at the time the Acceptance falls due. In case of an Acceptance in foreign money, the risk of exchange is an all-important factor in view of the extreme fluctuations to which the exchanges are sometimes subject.

THIRD: Benefit of the money rates quoted in the New York market, which on the average are likely to be lower than those of other money centers. New York has now a well-developed discount market, and the ever increasing demand for Bank Acceptances as a form of investment is plainly in evidence.

FOURTH: Advantage of direct service. Contingencies frequently arising in connection with foreign shipments can

F. R. 288

(MAY BE COPIED)

APPLICATION FOR

COMMERCIAL LETTER OF CREDIT

No.	
ADVISED	
CABLED	
ACKNOWLEDGED	

The Mechanics & Metals National Bank
OF THE CITY OF NEW YORK
Foreign Department,
New York City.

SPECIMEN

January 25th, 1917.

GENTLEMEN:

Please open a confirmed documentary credit by mail

on Buenos Aires (Name of City)

for account of ourselves (Purchaser)

not to exceed the sum of about $16,000.00

in favor of B. and Company, Buenos Aires (Shipper)

available by drafts for full invoice value,

drawn at 90 days Sight (Sight, or Thirty, Sixty, Ninety Days, or Four Months)

covering shipment(s) of 48 bales of wool at 30 cents per lb. (Kind and Quantity of Merchandise)

cost, freight New York

to New York (Destination)

against delivery of the following documents: Invoice, Consular invoice,

bills of lading to the order of the Mechanics and Metals

National Bank

Marine / War risk insurance is to be covered by ourselves in New York (Shipper or Purchaser)

Credit to be available until March 31st 1917.

SPECIAL INSTRUCTIONS:

Bills of lading must show freight prepaid

SPECIMEN

Yours truly,

B. and Company

be adjusted more promptly, cheaply, and effectively, between the American banker and the foreign shipper or his banker, than could be done if such adjustments had to be made via the London banker, as would be necessary in using a Sterling credit. *This point should not be underestimated.* In these days of abnormal fluctuation in prices for all kinds of merchandise, a deal is sometimes made or unmade according to the promptness with which the American bank is able to back up the transaction, either as a whole or in regard to some technical point suddenly raised by the shipper.

Dollar Acceptances drawn on National Banks against imports are generally drawn against what is known as a Commercial Letter of Credit. A commercial credit is an undertaking on the part of the bank to loan its credit (not its funds), to a customer. The customer, who is the original recipient of this extension of the bank's credit,

LETTER OF CREDIT No M-704

THE MECHANICS & METALS NATIONAL BANK

OF THE CITY OF NEW YORK.

NEW YORK, January twenty fifth 19 17.

B. and Company,
Buenos Aires.

Gentlemen:-

We hereby authorize you to value on us at ninety days' sight for account of Messrs. A. and Company, New York, for any sum not exceeding the aggregate amount of

U. S. $16,000.00
(SIXTEEN THOUSAND DOLLARS U. S. CURRENCY)

against shipment of 43 bales of wool at 30 cents per lb., cost and freight New York.

Full set of bills of lading for such shipment made out to the order of the Mechanics & Metals National Bank of the City of New York, together with invoice and consular invoice, must accompany the draft. Marine and war risk insurance are covered in New York. Bills of lading must show freight prepaid.

All drafts drawn against this credit to be drawn and negotiated on or before March 31, 1917, and to contain the clause:

"Drawn under your Letter of Credit #M-704."

The amounts so drawn to be endorsed on this Letter of Credit.

We hereby agree that such drafts as you may draw by virtue of this credit and in accordance with the above stipulations, shall be accepted on presentation, and paid at maturity.

Yours respectfully,

Manager Foreign Department.

Asst. Manager Foreign Department.

SPECIMEN
SPECIMEN

utilizes it by making it available in favor of the foreign shipper. He therefore requests the bank to notify the shipper that the latter may draw on the bank, up to a certain amount and within a certain time, provided certain specified shipping documents are attached to the draft.

For example: A and Co. of New York have bought from B and Co. in Buenos Aires, forty-eight bales of wool at thirty cents a pound, cost freight New York; marine and war risk to be covered by A and Co. in New York, at their own expense. As this contract is subject to the opening of a ninety days sight bank credit, A and Co. file with their New York bank the proper application for a commercial credit (see p. 17).

The Bank having passed favorably on the application thereupon issues its Letter of Credit (see p. 19).

A and Co., upon receiving the instrument, forward it by mail to B and Co. in Buenos Aires, or, if necessary, have its contents communicated to the beneficiaries through the bank by cable.

New York, ... 19.....

TO THE

MECHANICS & METALS NATIONAL BANK OF THE CITY OF NEW YORK

GENTLEMEN:

Letter of Credit having been issued at my/our request of which a true copy is on the other side, I/we hereby agree to its terms, and in consideration thereof I/we agree with you to provide in New York, one day previous to the maturity of the bills drawn in virtue thereof, sufficient funds in cash, to meet the payment of the same with ..... per cent commission, and I/we undertake to insure or have insured at my/our expense, for your benefit, against risk of Fire, Sea and War, all property purchased or shipped pursuant to said Letter of Credit, in Companies satisfactory to you.

I/we agree that the title of all property which shall be purchased or shipped under the said Credit, the bills of lading thereof, the policies of insurance thereon and the whole of the proceeds thereof, shall be and remain in you until the payment of the bills referred to and of all sums that may be due or that may become due on said bills or otherwise, and until the payment of any and all other indebtedness and liability now existing or now or hereafter created or incurred by me/us to you on any and all other transactions now or hereafter had with you, with authority to take possession of the same and to dispose thereof at your discretion for your reimbursement as aforesaid, at public or private sale, without demand or notice, and to charge all expenses, including commission for sale and guarantee.

Should the market value of said merchandise in New York, either before or after its arrival, fall so that the net proceeds thereof (all expenses, freight, duties, etc., being deducted) would be insufficient to cover your advances thereagainst with commission and interest, I/we further agree to give you on demand any further security you may require, and in default thereof you shall be entitled to sell said merchandise forthwith, or to sell "to arrive," irrespective of the maturity of the acceptances under this Credit, I/we being held responsible to you for any deficit, which I/we bind and oblige myself/ourselves to pay you in cash on demand.

In case I/we should hereafter desire to have this Credit confirmed, altered or extended by cable (which will be at my/our expense and risk), I/we hereby agree to hold you harmless and free from responsibility for such confirmation, alteration or extension and from errors in cabling, whether on the part of yourselves or your Agents, here or elsewhere, or on the part of the cable companies.

This obligation is to continue in force, and to be applicable to all transactions, notwithstanding any change in the composition of the firm or firms, parties to this contract or in the user of this credit, whether such change shall arise from the accession of one or more new partners, or from the death or secession of any partner or partners.

It is understood and agreed that if the documents representing the property for which the said Credit has been issued are surrendered under a trust receipt, collateral security satisfactory to the Mechanics & Metals National Bank of the City of New York, such as stocks, bonds, warehouse receipts or other security, shall be given to the Mechanics & Metals National Bank of the City of New York, to be held until the terms of the Credit have been fully satisfied and subject in every respect to the conditions of this agreement.

It is further understood and agreed in the event of any suspension, or failure, or assignment for the benefit of creditors on my/our part, or of the non-payment at maturity of any acceptance made by me/us, or of the nonfulfillment of any obligation under said Credit or under any other Credit issued by the Mechanics & Metals National Bank of the City of New York on my/our account, or of any indebtedness or liability on my/our part to you, all obligations, acceptances, indebtedness and liabilities whatsoever shall thereupon, at your option then or thereafter exercised, without notice, mature and become due and payable.

It is understood and agreed that you shall not be held responsible for the correctness or validity of the documents representing shipment or shipments, nor for the description, quantities, quality or value of the merchandise declared therein.

.....

.....

SPECIMEN

SPECIMEN

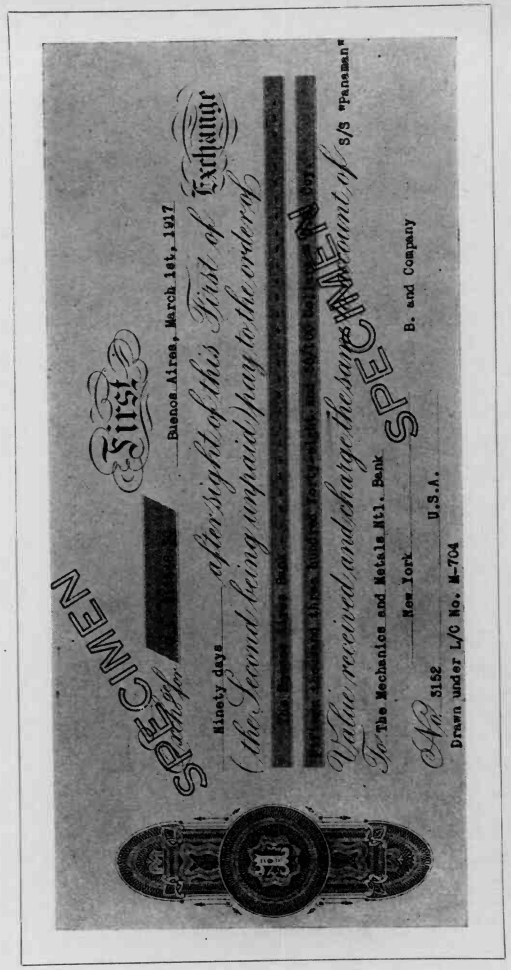
In order to protect the Bank, A and Co. sign an agreement (see p. 21).

B and Co. in Buenos Aires, upon receiving the credit, and having ascertained that the terms of the credit agree with the terms of sale, place the shipment aboard steamer, prepaying the freight according to contract, and taking out the bill of lading in the name of the New York bank according to the terms of the credit. B and Co. then draw up their draft for the invoice amount (see p. 23).

To this draft are attached the invoice, consular invoice and full set of bills of lading. B and Co. take these to their banker in Buenos Aires, producing at the same time the Letter of Credit of the New York bank. The Buenos Aires banker thereupon buys the draft with the documents attached, at the current rate for bank drafts at ninety days sight on New York, paying B and Co. the equivalent in Argentine currency.

B and Co. get a high price for their dollar draft; because—

1. The discount for the ninety days,


SPECIMEN
First
Buenos Aires, March 1st, 1917
Ninety days after sight of this First of Exchange
(the Second being unpaid) pay to the order of
Value received and charge the same to account of S/S "Panaman"
To The Mechanics and Metals Nti. Bank
New York
B. and Company
No. 5152
U.S.A.
Drawn under L/C No. M-704
SPECIMEN

INTENTIONAL SECOND EXPOSURE

In order to protect the Bank, A and Co. sign an agreement (see p. 21).

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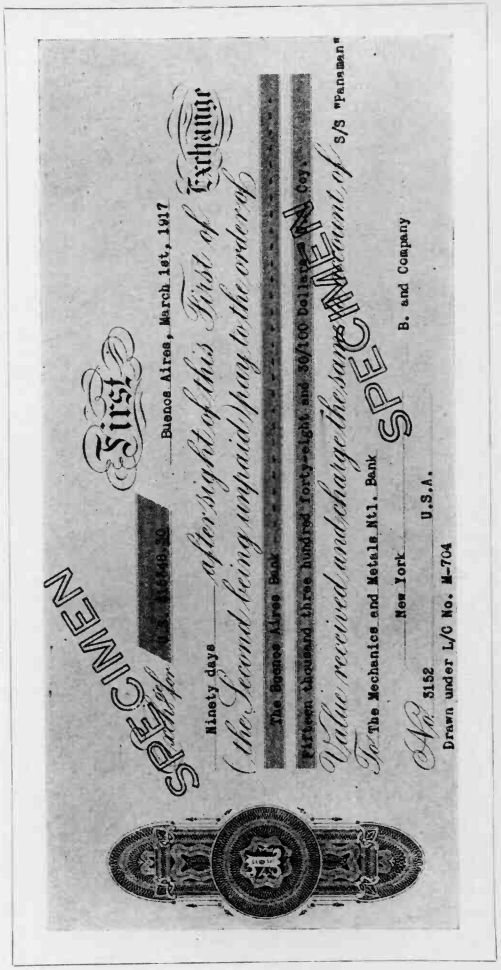
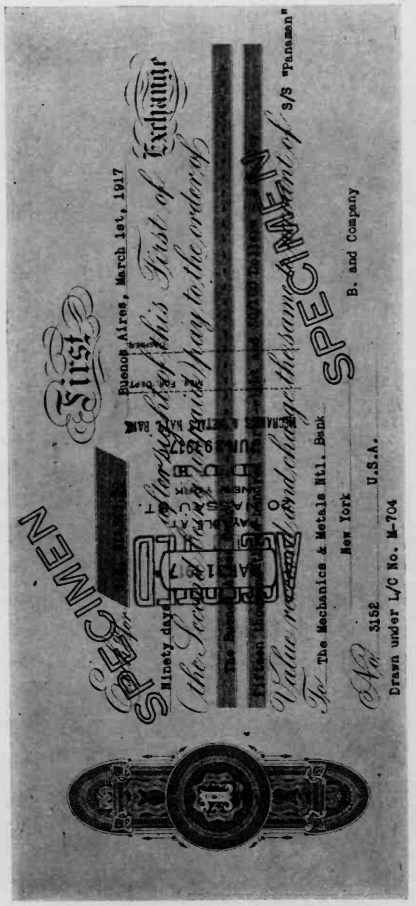

SPECIMEN
First
Buenos Aires, March 1st, 1917
Sixty days after sight of this First of Exchange
(the Second being unpaid) pay to the order of
The Buenos Aires Bank
Fifteen thousand three hundred forty-eight and 80/100 Dollars
Value received and charge the same to account of S/S "Panaman"
To The Mechanics and Metals Ntl. Bank
New York
B. and Company
A/C 5152
U.S.A.
Drawn under L/C No. M-704
SPECIMEN

which the draft has to run after it is accepted, is figured according to the New York discount market, which on the average is likely to be considerably below that of any other money center.

2. No bill stamp is charged in New York as would be the case of London or the continent.

B and Co., the shippers, having knowledge of these advantages, were therefore able to quote to A and Co. a lower selling price for the merchandise than would have been possible had A and Co. offered a Pound Sterling or other credit. In other words, the American importer is enabled to derive the full benefit growing out of the use of the dollar credit.

The Buenos Aires banker in the meantime has forwarded the draft and the documents to his New York correspondents, who, upon arrival, present them to the drawee bank for acceptance, in this case to the Mechanics and Metals National Bank. The latter, upon verifying the draft and documents with the terms of the credit, "accepts" the draft by affixing its



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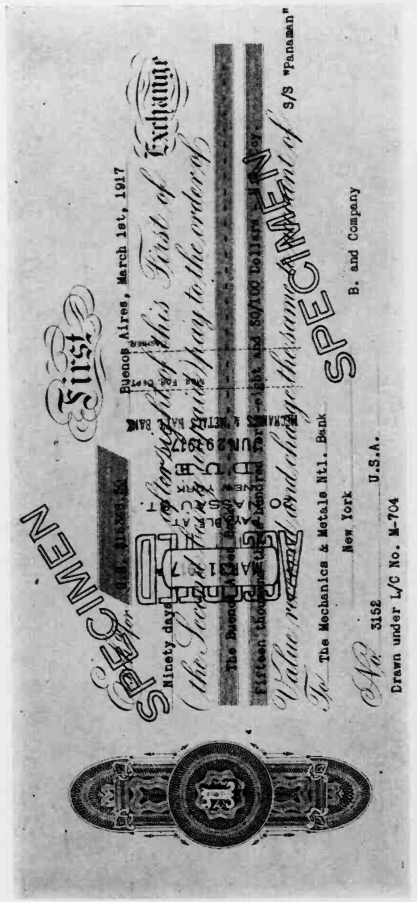


stamp and signature, returning the same to the party that presented it, retaining, however, the shipping documents.

For fac-simile of draft after it has been accepted see p. 25.

The presenting bank either holds the draft until maturity or discounts it in the open market, in accordance with the instructions of the South American banker. In the meantime the steamer carrying the wool has arrived and A and Co. request delivery of the shipping documents in order to enable them to make custom house entry and take possession of the goods. It will be readily understood that by giving up the shipping documents the New York bank is giving up its only collateral. The bank's interest must be protected and the documents are therefore surrendered against cash, under rebate for the unexpired time the draft has to run, or against approved security; or, if the client is of good financial and moral standing and has the confidence of the bank, against what is called a "Trust Receipt". (See p. 27.)

F D No 114

TRUST RECEIPT.

New York, April 2nd 1917.

Received from The Mechanics & Metals National Bank of the City of New York, the merchandise specified in the Bills of Lading per S/S "Panaman" Buenos Aires dated March 1st 1917., viz:

Marks and Nos.

P C
W F 155/200 48 bales of wool

SPECIMEN

consigned to me (us) by them for sale on their account, and in consideration,

I (we) A. and Company

of New York hereby agree to hold said goods in trust for The Mechanics & Metals National Bank, and at their disposal for the purpose of selling the same, and, in case of sale, to deliver as soon as received, the full net proceeds thereof direct to said Mechanics & Metals National Bank, as security for due provision for the acceptances of the Mechanics and Metals National Bank of the City of New York

I (we) further agree to keep said property insured against fire, payable in case of loss to The Mechanics & Metals National Bank, of the City of New York, with the understanding that they are not to be chargeable with any insurance incurred thereon, hereby waiving any lien which I (we) might otherwise have, as regards The Mechanics & Metals National Bank of the City of New York, for insurance, duties, or charges to be paid thereon.

Amount of Acceptance: $15,348.30 due June 29th, 1917.

Credit dated January 25th, 1917
No. M-704

A. and Company

SPECIMEN

According to the Trust Receipt the customer is obligated to hold the goods in trust for the bank, and, when sold, to turn the proceeds over to the bank immediately upon collection of the money, which is to be used in liquidation of the amount of the Acceptance. As we have seen from the "Agreement", the money to meet the Acceptance must be paid to the accepting bank at the latest one day before the maturity of the draft. By that time (after ninety days) the goods have usually been disposed of and these acceptances are therefore essentially self-liquidating.

DOLLAR ACCEPTANCES AGAINST EXPORTS

The procedure of financing exports through the medium of Dollar Acceptances differs somewhat from that used in financing imports.

A foreign buyer has bought goods in the United States. The American exporter who sold the goods demands a bank credit against which he can draw when shipment has been effected. The buyer abroad arranges with his local bank for the credit, and the foreign bank in turn requests its New York bank correspondent to open a credit in favor of the American shipper, available by the latter's ninety days sight drafts on the New York bank, such drafts to be accompanied by certain shipping documents which are then specified. The American shipper, after having effected shipment and secured the bill of lading and other documents required, draws his draft and presents ~~the latter~~ to the New York bank for acceptance, together with

the required shipping papers. The New York bank "accepts" the draft, to fall due in ninety days, and returns the accepted draft to the shipper, forwarding the shipping documents by first mail to the foreign bank.

The foreign bank turns these documents over to its client, the buyer of the goods, against such security as it may see fit. Funds to meet the Acceptance on the due date are guaranteed and furnished by the foreign bank to the New York bank. This part of the transaction lies entirely between the two banks.

In the mean time, the American shipper, who in payment for his shipment now holds a "Bank Acceptance", either discounts that Acceptance with his own bank, or sells it in the open market at what is called "the ruling rate for Member Bank Acceptances", thus receiving his money.

The advantages of the Dollar Acceptance in this case are obvious: The foreign buyer wants ninety days' time at the lowest cost; this the American seller gives him. Knowing that he can sell the Acceptance which

he receives from the New York bank at the lowest possible rate, he (the seller) adds only a small percentage to his selling price in order to cover himself for this discount. The American seller thus is enabled to quote lower prices than at any time before the passage of the Federal Reserve Act, when he was compelled to draw on some foreign bank, which procedure compelled him to add to his price a good margin to protect himself against loss in the exchange, against a higher discount, and against the cost of the bill stamps.

It may be said here that the American exporter who demands a bank credit to cover his sale is still too insistent upon receiving a "sight" credit, under which he receives "cash against documents". If we are to remove a positive restriction from our export trade it is imperative that our exporters consent to drawing "long" drafts on the American banks which open the credits, if so requested by the foreign buyers. The latter want time in which to make a "turnover", and this can easily be granted by the American sellers at low

cost and little or no risk. The excuse of some business houses that they do not care to be contingently liable as drawers of such Acceptances is irrelevant, since such contingent liability is unimportant in view of the fact that the acceptors of such drafts are strong banks which have become still stronger on account of being members of the Federal Reserve System.

Not all exports are covered by "Bank Credits", in fact, the majority are not. Notwithstanding, Bank Acceptances have been successfully employed in the financing of such exports, particularly exports to South and Central America, the banks paying with their credit by giving their "acceptance" instead of paying with funds when purchasing documentary drafts on those countries.

Bank Acceptances may be employed in anticipation of actual exports. For instance: A merchant has a large order for an export shipment; he may, upon having made proper arrangement with his bank, draw long drafts on the latter, using the funds thus created for the purchase or

preparation of the shipment. After the shipment has been made, the draft on the foreign purchaser or the foreign purchaser's bank, together with the relative shipping documents, are handed in to the bank for discount or collection, the bank in turn using the proceeds of this draft in liquidation of the original Acceptance.

This method has been successfully used since the outbreak of the war, and due credit should be given to the Federal Reserve Board for its intelligent and practical interpretation of the law.

DOLLAR ACCEPTANCES

a "*Against domestic shipment of goods, providing shipping documents conveying or securing title are attached at the time of acceptance.*"

b "*Secured at the time of acceptance by the warehouse receipt or other such document conveying or securing title covering readily marketable staples.*"

In order to finance his purchases and take advantage of the cash discount, the merchant formerly went to his bank and borrowed on his promissory note such funds as he required. The rate of interest which he had to pay varied according to the state of the money market, while the money market in turn always showed the effect of our old banking system, with its lack of rediscount facilities and its consequent tendency to sudden and abnormal fluctuations.

Today, the merchant who wants to borrow is privileged to pursue a different

course. Take the case of a buyer who has to meet a draft for $50,000, covered by domestic shipping documents.

The buyer, having made the proper arrangements with his bank, authorizes the latter to "accept" the seller's draft for $50,000 drawn upon the bank—(*not* upon the buyer) provided the draft is accompanied by certain specified documents, such as invoices, railroad bills of lading, etc. There are instances when it is more practicable that the customer himself draw upon the bank instead of the seller. However, the other method is the more usual one. The draft is presented by the seller, accepted by the bank and returned to the seller. The documents are withheld by the bank and turned over to the customer against the familiar trust receipt.

The seller now has the "Bank Acceptance" for $50,000 which he can readily discount in the open market. Thus the actual funds are provided under competition by the banking and investing community at large.

The procedure to create Dollar Accept-

ances secured by warehouse receipts or other documents covering readily marketable staples does not vary materially from that outlined, except that the customer of the bank usually does not designate any third party to draw the draft on the bank, but draws it himself.

The advantages of these acceptances are four-fold:

FIRST: In the case of the seller, he receives his money promptly.

SECOND: The bank's customer has obtained his loan (or rather credit) at a lower cost than by the use of the promissory note, the rate for a three months' promissory note, all other things being equal, being higher than the discount rate for a three months' Bank Acceptance plus acceptance commission. This difference is eloquently illustrated by the different valuation applied by European bankers to an investment of ready negotiability—as compared

with one that locks up the funds of the bank.

THIRD: The bank is able to accommodate its customer more readily, since it advances only its credit, the ultimate buyer of the Acceptance advancing the actual money.

FOURTH: It has a balancing effect on the money market.

Thus, through the use of the Bank Acceptance the bank can take care of the needs of its customers without carrying the merchant's paper in its portfolio.

In other words, the bank, when granting accommodations, is not dependent upon the amount of loanable funds it has available.

TRADE ACCEPTANCES

There is a fundamental difference between a Trade Acceptance and a promissory note.

A Trade Acceptance is an *order* of the seller on the buyer to pay, and its self-liquidating character is prima facie.

A note is a promise by the maker to pay, and its self-liquidating character is *not* prima facie.

A Trade Acceptance must be drawn by the seller on the purchaser *for goods sold*, while there is nothing to indicate the origin of a promissory note.

While domestic Bank Acceptances cover commodities such as grain, cotton, coffee, copper, etc., usually involving large amounts, the Trade Acceptances are used in financing the ordinary business transaction between buyer and seller on direct sales of a bill of goods.

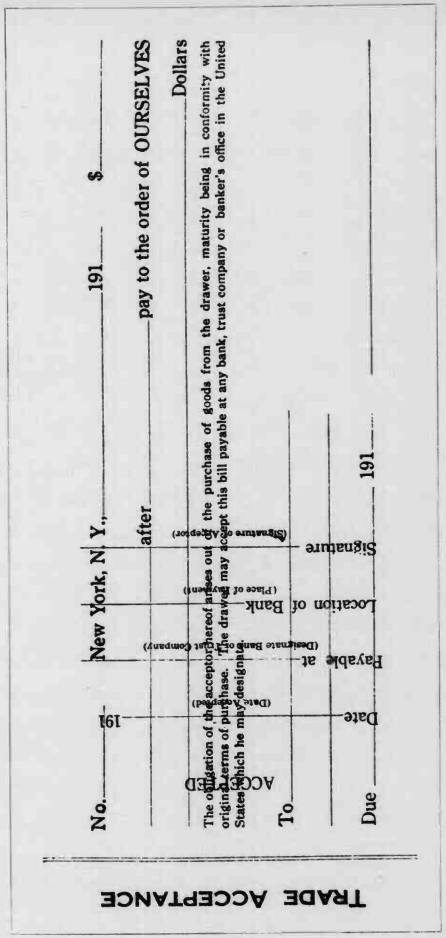
If, for instance, a merchant has sold a bill of goods on the terms of, let us say, 2/10/60 (sixty days net, 2% discount if

paid within 10 days), at the time the invoice is rendered, the invoice is accompanied by a sixty days' sight draft duly filled out, drawn on the buyer, together with a letter requesting the buyer to "accept" and to return the draft, or, if he should prefer, to pay the bill less two per cent within ten days and return the draft unaccepted.

Should a customer develop the habit of postponing the "sighting" of the draft unduly long, thus automatically extending the due date for a corresponding period, the seller should draw on such customer at a fixed number of days after date, say sixty days after date. By the use of such "days date" bills, although acceptance may be delayed, the due date is not affected. In case the seller does not wish the buyer to take possession of the goods unless the latter has accepted the draft, the shipping documents, such as railroad bill of lading, etc., are attached to the draft. The draft is marked "D/A" (documents to be delivered against acceptance) and then given to the bank for the purpose of obtaining the Acceptance.

Shipping documents should if possible be in negotiable form, i. e., the bill of lading should be made out to shipper's order endorsed in blank.

Some business houses, recognizing the importance of the Trade Acceptance, and in an endeavor also to make it advantageous to their customers, are granting special inducements, either by allowing what is termed an "Acceptance discount" or by granting additional time, or some other concession in consideration of obtaining an Acceptance. The form of Trade Acceptances varies, of course, according to the nature of the business. The one shown on the adjoining page is a common form and is recommended for general use. It has been adopted and approved by the American Trade Acceptance Council.


TRADE ACCEPTANCE
No.
Due
191
To
ACCEPTED
Dollars
$
191
New York, N. Y.,
after
pay to the order of OURSELVES
The obligation of the acceptor hereof arises out of the purchase of goods from the drawer, maturity being in conformity with original terms of purchase. The drawer may accept this bill payable at any bank, trust company or banker's office in the United States which he may designate.
Date
(Date to be inserted by Acceptor)
191
Payable at
(Designate Bank or Trust Company)
Location of Bank
(Place of Payment)
Signature
(Signature of Acceptor)

ADVANTAGES OF THE TRADE ACCEPTANCE

Trade Acceptances have been used in European countries for generations on account of their proven economic value. They are used to put Book-Credits into negotiable form, and constitute a system by which Book-Credits may promptly be converted into cash.

Our present system of open book accounts, to which we have clung so tenaciously, is productive only of dead capital, and is therefore economically wrong in that it creates immobile credit instead of mobile credit. By converting an open book account into a Trade Acceptance, the credit represented by the account becomes immediately available for further use by the seller, because a Trade Acceptance may readily be discounted with the bank, thus enabling the merchant to re-invest in his business the amount of capital represented by the account.

The use of the Trade Acceptance also re-

moves from merchants and manufacturers the necessity of acting as bankers for their customers by way of open accounts. The old practice results in loss of interest on overdue accounts, and waste and loss from slow collections.

Through the use of the Trade Acceptance the necessity of furnishing credit falls where it belongs, namely, upon the banks. The function of our commercial banks is to deal in credits, and in case of necessity they can rediscount these Acceptances with the Federal Reserve Banks, furnishing the latter with eligible paper which may be used as a basis for currency, and thus creating an elastic currency system which will expand or contract according to the needs of the country.

The Trade Acceptance curtails the buyer in taking unearned or unauthorized discounts.

The Trade Acceptance, in legal proceedings, is superior to the open book account, since it is a written acknowledgment of debt, and a promise to pay on a fixed due

date. In some of the foreign countries the law provides that judgment may be obtained within three to five days on the evidence of an unpaid Acceptance and protest, provided the protest is taken within the time limit set by law. This illustrates the position of importance which the Acceptance holds in the economic structure of the countries abroad.

By the use of the Trade Acceptance, friction between the buyer and seller is reduced to a great extent. Not being able any longer to take advantage of his position the buyer cannot return goods without justification or indulge in other abuses—abuses which in the past arose from the granting of the too-generous credit which resulted from the open book account system. Indirectly the retailer is paying dearly for this privilege. Elimination of the abuse referred to, when completely in effect, will mean the elimination of a great economic waste, and will tend materially to lower the cost of distribution from manufacturer to consumer.

The Trade Acceptance does not interfere

with the cash discount. Those houses which have been in the habit of putting out their own promissory notes in order to raise funds with which to take advantage of cash discounts, are now in a position to use the Trade Acceptances which they obtain from their own customers, discounting such acceptances with the bank.

From the bank's point of view Trade Acceptances constitute the safest, most liquid, and therefore most desirable asset, second only to Bank Acceptances. While Bank Acceptances, on account of their security, great liquidity, and consequent low discount rates, make an ideal "secondary reserve", the Trade Acceptance is more desirable as a permanent investment, which in case of need, however, may readily be converted into cash.

In lending on single name paper the banker lends on a security the self-liquidating character of which is not prima facie, and about the origin of which the banker usually has no definite knowledge. A Trade Acceptance, on the other hand, covers a definite transaction, the details

of which may readily be ascertained; its self-liquidating character is prima facie. It carries two names instead of one as security and is therefore infinitely stronger than the promissory note.

Another feature which adds to the desirability of the Trade Acceptance for banks, as an investment, is its eligibility for rediscount with the Federal Reserve Bank.

The Trade Acceptance (aside from the Bank Acceptance) constitutes the ideal collateral for the issuance of Federal Reserve notes. In fact, under the banking system of no other country of importance in the world, where credit forms the basis of currency, can single name paper be rediscounted with the central banks, while on the other hand, two name Acceptances are required, and in some cases even an additional endorser is necessary.

The Federal Reserve Board, recognizing the importance and advantages of the Trade Acceptance, has authorized special low rates for this class of paper; these rates are generally one-half per cent lower than the

rate for promissory notes. Although, except in some special cases, the law does not permit the Federal Reserve banks to discount a Trade Acceptance having a longer maturity than ninety days, this does not mean that Trade Acceptances must not be drawn for a longer period. In case of a four months' Acceptance, for instance, the commercial bank simply carries it until it comes within the ninety days' limit, when it may be discounted with the Federal Reserve Bank.

There is still another advantage in the use of Trade Acceptances in their relation to the banks: Under section 5200 of the National Bank Act, all national banks are limited in their loans to any single borrower to ten per cent of their capital and surplus. This ten per cent limitation, however, *does not apply* where a national bank discounts its customers' Trade Acceptances.

Section 5200 of the National Bank Act makes the following provision in regard to such discounts: "But the discount of bills of exchange drawn in good faith against actually existing values, and the discount

of commercial or business paper actually owned by the person negotiating the same shall not be considered as money borrowed."

The advantage of the Trade Acceptance in view of the above is obvious, particularly to the smaller banks. In many cases, these banks, on account of their location, count large mills and industrial concerns among their customers, who usually are large borrowers. Having loaned them up to their ten per cent limit, the banks are unable to extend further accommodation. The result is that these concerns have to go outside of their own city in order to obtain additional loans, while the banks have to look for other loans in which to invest their money—loans which might not be as desirable as those which they had to forego. If, now, these firms eliminate their open book account system and sell their goods against Trade Acceptances, they are enabled to turn these Trade Acceptances over to their bank, which is then in a position to grant accommodation without regard to the ten per cent limitations.

The advantage to the banker in discounting his customers' Trade Acceptances instead of his promissory notes, in case his customer goes into bankruptcy, need hardly be enlarged upon. Although a promissory note is backed by the entire assets of the maker, including the Accounts Receivable, these Accounts Receivable become part of the assets of the bankrupt's estate, while the holder of the note merely becomes a creditor along with the other creditors. In case of a Trade Acceptance, the holder collects from the acceptor when due, keeping the money, whether or not the "Drawer" in the meantime has become a bankrupt.

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ADVANTAGES OF TRADE ACCEPTANCES TO THE BUYER

Having spoken of the advantages of the Trade Acceptances to the seller and the banker, what now are the advantages to the buyer?

First of all, those merchants who agree to settle their purchases by Trade Acceptances, will be looked upon by the sellers as belonging to a class of *preferred* customers. The man who, instead of buying against the open account, is willing to accept a draft and thus go on record that he owes the shipper a certain sum of money, agreeing to pay at a certain fixed future date, will naturally be considered as one who has the affairs of his business well in hand. This fact will soon find recognition in an advantageous mercantile rating. In other words the use of the Trade Acceptance by the buyer in settling his obligations enhances his commercial standing.

THE FOREIGN TRADE CLUB

The buyer who insists upon conducting his business on the open book account basis pays dearly for doing so; the open book account spells high prices, in fact, highest prices. On the other hand, the buyer who is willing to give his "Acceptance" for the debt which he has incurred, receives the full benefit of this method by obtaining for himself either what is termed an "Acceptance Discount" or, if he prefers, additional time in which his Acceptance is to fall due.

Trade Acceptances place the buyer in a position to secure lower prices, and thus compete on favorable terms with those who are able to take the cash discount, while he is far out-distancing those who buy on open account.

It is a poor rule that does not work both ways; the rule of Trade Acceptances does work both ways. It enables the retailer to ask his customer for Acceptances on sales which he makes on a "time" basis. Acceptances thus obtained can be rediscounted by turning them over to the jobber and wholesaler or to the bank.

The use of Trade Acceptances would receive its greatest impetus if large merchants, manufacturers and corporations were to lead the way by using this method in settling their own obligations. Aside from the good example, the use of Trade Acceptances, or Bank Acceptances, would prove a distinct advantage to large concerns that are now in the habit of taking cash discounts. By conducting their business on an Acceptance basis, these concerns would be able to considerably increase their turnover without an increase in the capital investment. They could do the same volume of business on smaller capital, or with less borrowed capital. On the other hand, the method of taking cash discounts instead of acceptance discounts, necessitates the accumulation of cash to be held in readiness, during which period it lies idle and is therefore unproductive.

The business community of this country must be taught to look at the question of Acceptances in its broader aspects; it must be made to realize that by using the facilities

for *liquid* credit which the country now offers, by using the Trade Acceptances and resorting to Bank Acceptances when necessary or advisable, it is not alone doing something decidedly beneficial to itself, but it is also performing a patriotic duty.

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